Supreme Court of the United States

October Term, 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945, and LESTER MARTIN,

Petitioners and Appellants Below,

AGAINST

EDWIN G. BAETJER, GEORGE C. CUTLER, AUSTIN McLANAHAN and A. H. S. POST, constituting the Seaboard Air Line Railway Company Underlying Bondholders' Protective Committee,

Respondents and Appellees Below.

Brief in Support of Petition for Writ of Certiorari.

ABRAHAM MITNOVETZ,
of New York City,
Attorney for Petitioners.

HARRY O. LEVIN,
of Baltimore, Maryland,
Of Counsel.

Brief in Support of Petition for Writ of Certiorari.

Opinions of Courts Below.

The opinion of the Circuit Court of Appeals (R. 120-125) is reported in 146 Fed. 2nd 762. The order of the United States District Court for the Eastern District of Virginia, denying and dismissing the petition filed by the petitioners herein, is printed in the Record on Appeal (R. 15-16).

Jurisdiction.

1. The decree of the Circuit Court of Appeals to be reviewed was entered on January 3, 1945 (R. 125).

2. The jurisdiction of this Court is invoked under the Act of February 13, 1925 (C. 229; 43 Stat. 938), amending the Judicial Code Section 240, Title 28, U. S. C. A., Section 347, and under Rule 38, subdivision 5, of the Rules of the Supreme Court.

3. The decree of the Circuit Court of Appeals affirmed the order of the District Court which denied and dismissed the petition filed herein, which sought to enjoin the respondents from representing conflicting interests in a reorganization in equity and to compel the withdrawal of the bonds deposited with the respondent committee. The decree of the Circuit Court of Appeals in effect sanctioned the representation of conflicting interests by a protective committee in a reorganization, which is probably in conflict with applicable decisions of this Court.

4. The cases believed to sustain said jurisdiction are as follows:

Woods v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262;
American United Mutual Life Insurance Company v. *City of Avon Park*, 311 U. S. 138;
Bullard v. *City of Asco*, 290 U. S. 179.

Statement of the Case.

This has already been stated in the preceding petition (*supra*, pp. 2-6), which is hereby adopted and made a part of this brief.

Specification of Errors.

1. The Circuit Court of Appeals erred in affirming the order of the District Court which denied and dismissed the petition filed herein, which sought to enjoin the respondents from representing conflicting interests in a reorganization in equity and to compel the withdrawal of the Georgia and Alabama bonds represented by the respondent committee.

2. The Circuit Court of Appeals erred in sanctioning the representation by a bondholders' protective committee of conflicting interests in a reorganization, contrary to applicable decisions of this Court, as indicated in the cases of *Wood* v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262; *American United Mutual Life Insurance Company* v. *City of Avon Park*, 311 U. S. 138; and *Bullard* v. *City of Asco*, 290 U. S. 179.

ARGUMENT.

Summary of the Argument.

Point I.—A conflict of interest unquestionably exists between the several divisional mortgages purportedly represented by the Underlying Bondholders' Protective Committee.

Point II.—A Protective Committee may not represent conflicting interests as it is unfair to investors and not consistent with public policy or public interest.

Point III.—This Court has held that Protective Committees, as well as Indenture Trustees, are fiduciaries, and cannot represent conflicting interests in a reorganization. The decree of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court.

POINT I.

A conflict of interest unquestionably exists between the several divisional mortgages purportedly represented by the Underlying Bondholders' Protective Committee.

The total amount of new securities allocated to the underlying divisional mortgages as a whole is *fixed* and *limited* and is far less than the face amount of the present outstanding accrued debt due to the said underlying divisional mortgages.

In so far as one divisional mortgage receives less than its full and accrued principal and interest, it is apparent that any proportionate increase or difference in the amount of securities received by one divisional issue will be at the expense of another or several of the other divisional mort-

gage issues. It is therefore to the advantage of each divisional group to reduce the amount received by the other mortgage groups, since it must mathematically result in increasing the share received by such mortgage division. It follows that the interests of each divisional issue necessarily conflicts with that of the other divisional issues unless *all* are fully paid.

This fact is admitted by the respondents in paragraph B of their answer (R. 11) which states:

> "B. Your Respondents admit that in many instances various theories proposed in the reorganization proceedings in this cause benefit some one or more issues of divisional bonds represented by the Underlying Committee more or less than one or more of the other of such issues, and in that sense, and in the sense that an allotment of new securities in reorganization to any issue of outstanding security holders decreases the aggregate allotment of new securities that can be made to other issues, there is a conflict of interest between the various issues of underlying bonds as to the plan of reorganization to be adopted. In the opinion of the Underlying Committee, however, the many mutual interests of the divisional issues and the advantages of presenting through the Underlying Committee a united front for such divisional issues far outweigh the disadvantages of any such conflict of interest."

as well as by the testimony of Mr. Baetjer, Chairman of the Underlying Bondholders' Committee, who admitted that a conflict of interest existed between the various mortgage divisions the moment there was a limited common fund to be divided among the several underlying liens (R. 20-21; 25-28).

Mr. Baetjer admitted that one of the primary reasons his committee was formed to represent ten different underlying divisional mortgages was due to the fact that his clients, the trust companies and banks (who are represented on the committee), owned bonds of all of said issues (R. 17-19; 29-30).

He further stated that at the time he organized the Underlying Bondholders' Committee in August, 1931 his main objective was to see that all of the underlying bonds were paid in full, as occurred in the 1908 reorganization of the Seaboard Air Line Railway, and that the joinder of all the other underlying divisional liens at the time in one group gave him a strategic advantage in the pending reorganization under the then existing law.

It is pertinent to note at this moment, that although at the time when it was organized the Underlying Bondholders' Committee did not require the approval or permission of the Interstate Commerce Commission or the Securities Exchange Commission, under the then existing statutes, that the Underlying Bondholders' Committee made no attempt after the passage of such statutes to obtain such approval. Mr. Baetjer admitted, moreover, that he advised the committee to make no further solicitation of bonds, after the passage of the Bankruptcy Act of 1935, which required the approval of the Interstate Commerce Commission.

It is evident that if all the underlying mortgage liens represented by the Underlying Bondholders' Committee in the reorganization had been paid in full, that no conflict of interest would exist.

However, Mr. Baetjer admitted on cross-examination that he realized some time in 1934 or 1935 that all the underlying liens would not be paid in full (R. 26, 27, 28-31). Mr. Baetjer further admitted that he knew the several mortgage divisions represented by the Underlying

Bondholders' Committee were of different and unequal value (R. 20, 22, 23, 32).

It is clear therefore that Mr. Baetjer and the Underlying Bondholders' Committee knew in 1934 or 1935 that the funds to be received by the several underlying mortgages represented by the committee were limited and a conflict of interest necessarily existed between each of the mortgage divisions as to the amount to be allocated to each of the several mortgage divisions from the common fund in the reorganization.

Who was then to determine the equitable distribution of these limited funds to each of the mortgage issues?

Could a committee which purportedly represented several of the conflicting mortgaged issues properly determine the equitable distribution of such limited funds among such issues?

If a committee undertook to do this, could this be said to be a proper function or power of any protective committee? Is it not the proper function of a protective committee to fully protect and preserve to its greatest extent the rights of any class or issue it purports to represent?

Nevertheless Mr. Baetjer on cross-examination admitted that the Underlying Bondholders' Committee undertook to determine the equitable distribution of the limited funds to each of the underlying divisional liens they represented and contended that the committee had that right under the deposit agreement (R. 32, 34-35; 39-41).

To determine the equitable distribution of the limited funds to the several issues of bonds, it was necessary to determine the relative value of each of the mortgage divisions. To determine the value of each mortgage division it was necessary to determine their earnings or earning power.

Several theories or formulae were advocated for this purpose, since it is conceded that there is no recognized standard or formula fixed or recognized by law for this purpose (R. 34, 36-37).

Mr. Baetjer admitted on cross-examination that each proposed formula applied to the various divisional mortgages would produce different results, some more favorable to one mortgage issue and some more favorable to others (R. 34-37; 39, 54). He likewise admitted that the particular years which were used as a test period for the determination of earnings produced different and greatly varying results for each of the mortgage divisions, certain periods being more favorable to some of the mortgage issues and other periods being more favorable to certain of the other mortgage divisions (R. 37-40). Mr. Baetjer further admitted that each divisional mortgage issue, if left to its own bondholders and resources, would unquestionably advocate the formula and test period most favorable to that issue (R. 39, 41-44). Mr. Baetjer thereafter admitted that when the bondholders deposited their bonds and agreed to pay the committee for their services, they did so in the belief and on the understanding that their particular bond issues would receive the best representation possible (R. 40-42; 43).

It is evident, then that whatever formula the Underlying Bondholders' Committee would advocate would necessarily be beneficial to certain of the mortgage issues it represented and equally detrimental to others that it also represented (R. 38-45).

This was likewise true of the test period employed (R. 38-39) for the determination of the earnings of each of the mortgage divisions, as well as many other issues which arose in the course of the reorganization, such as the question of the treatment of passenger losses. Mr. France, who represented the Underlying Bondholders' Committee, admitted at the hearing on the Plan of Reorganization that the treatment of passenger losses advocated would help certain of the issues represented by him as well as hurt certain of the other issues likewise represented by the Underlying Bondholders' Committee (R. 50-51).

It cannot be disputed that the formula or test period advocated by the Underlying Bondholders' Committee for the determination of the earnings of the various divisions *was adverse* to the interests of the Georgia and Alabama bondholders, inasmuch as the application of such formula and test period, known as the "Wyer" Formula, resulted in designating the Georgia and Alabama Railway as a deficit division showing no divisional earnings, although Mr. Wyer admitted that the Georgia and Alabama Railway made tremendous contributions to the freight revenue and earnings of the system as a whole.

Mr. Baetjer testified at the hearing he did not believe the Georgia and Alabama Railway bond issue to be a good bond issue but considered it as one of the poor issues for which he was prepared to make concessions (R. 26-28). This attitude was unquestionably reflected by the Underlying Committee's counsel, Mr. France, one of the three members of the *Compromise Committee* and the *only* representative of the ten underlying mortgage divisions on the Compromise Committee appointed by the District Court when he sat on the Compromise Committee which made the final determination of the allocations to be made to the various mortgage divisions, and whose recommendations were fully confirmed by the District Court when it finally approved the Plan of Reorganization of the Seaboard Airline Railway Company.

Nor were the views and methods advocated by the Underlying Bondholders Committee accepted by all the other mortgage divisions represented by the Underlying Bondholders' Committee. That the views and methods advocated by the Underlying Bondholders' Committee were contrary to the interests and rights of other divisional issues was likewise stressed by the Trustee for the Atlanta and Birmingham Division, as well as by its separate protective committee (R. 46-50).

It is apparent, therefore, from the very nature of the conflict between the various mortgage issues that it is an absolute impossibility for the Underlying Bondholders' Committee to properly represent or even purport to represent in any court of equity all of the underlying divisional mortgage issues.

POINT II.

A Protective Committee may not represent conflicting interests as it is unfair to investors and not consistent with public policy or public interest.

Inasmuch as the Securities and Exchange Commission at the direction of Congress has considered this question thoroughly and exhaustively its views are pertinent as well as appropriate.

In its Report on Protective and Reorganization Committees, the Securities and Exchange Commission disapproved solicitation by a committee of more than one class of security holders, unless there was no material conflict between such classes, or unless such action was necessary in the public interest or for the protection of investors. (See Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees made pursuant to Sec. 211 of the Securities and Exchange Act of 1934.)

In this Report, the Commission quoted with approval a prominent member of the reorganization bar, to the following effect:

> "'* * * Above all things, see to it that neither your Committee nor any other committee represent conflicting interests. It is a rule to which there are few exceptions that the same protective committee should represent but one class of securities. It is

> rarely wise that the same committee should even represent both preferred and common stock, because some of the most perplexing questions which arise in reorganizations are as to the equitable adjustment of the relative participation to be accorded to preferred and common stock." (Report, Part II, p. 395).

It was further stated by the Commission that:

> "If the interests of the several classes of Security-holders are not to suffer as a result of concession too readily or unnecessarily made, their representatives at the conference table should have *undivided* loyalty to the class which they represent." (Report, Part II, p. 395). (Italics ours.)

It will be noted that this has been one of the principal objections voiced by the petitioners to the Compromise Committee which modified the Plan of Reorganization of the Seaboard Airline Railway which was finally approved by the District Court. It has always been the contention of petitioners that the views and interests of the Underlying Bondholders' Committee and Mr. France, its counsel, who sat on this Compromise Committee (and purportedly represented the Georgia and Alabama bondholders, as well as the other underlying mortgages) were adverse to the Georgia and Alabama bondholders and that Mr. France made unwarranted concessions affecting these bondholders.

Adopting these views, the General Rules and Regulations of the Securities and Exchange Commission now provide (Rule U-62, subdivision [j]):

> "(j) Solicitations of several classes of Security holders.—The solicitation of authorizations by one person, group of persons or committee shall not be

> made for more than one class of securities without the approval of the Commission, by order upon application, which application shall set forth facts showing that no material conflict of interest exists between the different classes of security holders concerning the subject matter of the solicitation."

The same practice is now followed by the Interstate Commerce Commission and was clearly illustrated by their ruling on the Georgia and Alabama Committee represented by the petitioners herein. Originally the Georgia and Alabama protective committee consisted of four members, including one Ralph Friedman. Mr. Friedman's application to the Interstate Commerce Commission disclosed the fact that his wife owned $120,000 principal amount of Seaboard First 4s of 1950. The Interstate Commerce Commission stated in its opinion that the holdings of Mr. Friedman and his wife created a conflict of interest which disqualified him from serving on the petitioners' committee, which was otherwise approved.

It must, however, be noted that paragraph (p) of Sec. 77 of the Bankruptcy Act specifically states that unless the protective committee applies to the Commission for authority, the sub-section is not applicable to a committee functioning prior to its enactment in 1935, but the same paragraph also states:

> "Provided, That with respect to committees which are not subject to this subsection (p) the Judge shall scrutinize and may disregard any limitations or provisions of any deposit agreements, committee, or other authorizations affecting any creditor or stockholder acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy, including the

collection of unreasonable amounts for compensation and expenses."

The intention clearly expressed and evidenced by this paragraph was simply not to invalidate any legal action or any legal rights or obligations which have theretofore been taken by any protective committee prior to the enactment of this Act. It was never intended to alter the equitable principles and rules which apply to all protective committees and which must be adhered to by any protective committee which purports to represent any class of security holders. The last sentence of this subdivision clearly states that the judge *must* restrain the exercise of any power and may disregard any limitations or provisions of any deposit agreements which he finds to be unfair and not consistent with public policy.

That the present position of the Underlying Bondholders' Committee is untenable is clearly supported by the views expressed by the Supreme Court in the following two recent cases:

Woods v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262;
American United Mutual Life Insurance Co. v. *City of Avon Park*, 311 U. S. 138.

These two cases are authoritative and clearly state the rules and principles applicable to all protective committees which seek to function as such. They apply with equal force to protective committees organized prior to August 27, 1935, or thereafter.

In the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al., supra*, decided February 2, 1941, two members of a protective committee were officers in the employ of the underwriter who was interested in the equity of the debtor company. Counsel

to the committee was not only counsel to the indenture trustee in the reorganization, but was also counsel to the indenture trustee and the committees for the neighboring properties. This Court in passing upon the question of allowances for fees and expenses in connection with the reorganization stated:

(p. 267):

> "* * * There was no unitary plan of reorganization for these several properties. But there were dealings between them by their common representatives—dealings attacked by petitioner as unfair to the instant company and defended by respondents as fair. That is not all.
>
> Counsel to the committee was not only counsel to the indenture trustee in this reorganization; it was also counsel to the indenture trustee and the committee for neighboring properties."

(p. 258):

> "* * * Furthermore, a reasonable compensation for services rendered necessarily implies loyal and disinterested services in the interest of those for whom the claimant purported to act. * * *" *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138.
>
> "* * * Where a claimant who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation. It is no answer to say that fraud or unfairness were not shown to have resulted. * * *" *Jackson* v. *Smith*, 254 U. S. 586, 589.
>
> "* * * The principle enunciated by Chief Justice Taft in a case involving a contract to split fees in

violation of the bankruptcy rule is apposite here: 'What is struck at in the refusal to enforce contracts of this kind is not actual evil results but their tendency to evil in other cases. * * *' *Weil* v. *Neary*, 278 U. S. 160, 173.

"* * * Where an actual conflict of interests exists, no more need be shown in this type of case to support a denial of compensation. * * *"

The rules and principles enunciated by this Court in the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al., supra,* clearly indicate that Sec. 77 (p) of the Bankruptcy Act or Sec. 205 (p) of the U. S. C. A. was never intended and cannot be interpreted to condone or permit any protective committee whether it was organized prior to August 27, 1935 or thereafter, to represent at any time conflicting interests.

The equitable principles pertaining to all protective committees have not been altered in any respect by Sec. 77 (p) of the Bankruptcy Act or Sec. 205 (p), U. S. C. A. It must be adhered to and complied with by any protective committee which purports to represent any class of security holders.

It is our contention that where a protective committee purports to represent several interests or security holders whose interests conflict, it is the duty of the lower Courts to restrain such a protective committee from functioning in order to comply with the mandate and principles set down by the Supreme Court of the United States.

POINT III.

This Court has held that Protective Committees, as well as Indenture Trustees, are fiduciaries and cannot represent conflicting interests in a reorganization. The decree of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court.

The principle that protective committees, as well as indenture trustees, are fiduciaries was authoritatively set forth in the case of *Bullard* v. *City of Asco*, 290 U. S. 179.

In the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262, this Court said:

p. 269:

> "A fiduciary who represents security holders in a reorganization may not perfect his claim for compensation by insisting that, although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one. Only strict adherence to these equitable principles can keep the standard of conduct for fiduciaries, 'at a level higher than that trodden by the crowd'."

See Mr. Justice Cardozo in

> *Meinhard* v. *Salmon*, 249 N. Y. 458, 464; 164 N. E. 545.

It may well be that the rights and obligations incurred by the Underlying Bondholders' Protective Committee as well as its acts up to August 27, 1935, were legal and cannot be attacked, provided, of course, that no conflict of interest existed at that time. The general rule, however, that no protective committee may represent conflicting interests must at all times be strictly and fully enforced.

In support of these views, this Court in the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262, further stated at p. 269:

> "Some discrimination, however, is necessary in applying the foregoing rule to claims for expenses. Reimbursement for all proper costs and expenses incurred in connection with the administration of the estate may be allowed (Sec. 242, Bankruptcy Act). The rule disallowing compensation because of conflicting interests may be equally effective to bar recovery of the expenses made by a claimant subject to conflicting interests. Plainly, expenditures are not 'proper' within the meaning of the Act where the claimant cannot show that they were made in furtherance of a project exclusively devoted to the interests of those whom the claimant purported to represent. On the other hand those expenditures normally should be allowed which have clearly benefited the estate."

It is pertinent to note that the Maryland Trust Company represented by Mr. Carlyle Barton, trustee for the Georgia and Alabama Terminal Company,* a subsidiary of the Seaboard Railroad, resigned as such trustee in the instant case in view of its position as Trustee for the Seaboard First 4s, one of the general mortgages of the Seaboard System to avoid any possible conflict of interest (R. 55).

It is respectfully submitted by the petitioners that the conflicting interests which appear in the instant case and which are represented by the Underlying Bondholders' Protective Committee are more powerful and apparent than that which appear in the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al., supra.*

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*This subsidiary was also ostensibly represented by the Underlying Bondholders' Committee which had on deposit many of its bonds.

CONCLUSION.

For these reasons, we respectfully submit that this petition for a writ of certiorari should be granted.

Respectfully submitted,

ABRAHAM MITNOVETZ,
Attorney for Petitioners.

HARRY O. LEVIN,
Of Counsel.

March, 1945.

BRIEF FOR THE RESPONDENTS IN OPPOSITION

Supreme Court of the United States

OCTOBER TERM, 1944

No. 1091

F. G. BADENHAUSEN, WILLIAM S. SPATCHER AND HOWARD H. HUBBARD, CONSTITUTING THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF GEORGIA & ALABAMA RAILWAY FIRST MORTGAGE CONSOLIDATED 5% GOLD BONDS, DUE 1945, AND LESTER MARTIN,

Petitioners

vs.

EDWIN G. BAETJER, GEORGE C. CUTLER, AUSTIN McLANAHAN AND A. H. S. POST, CONSTITUTING THE SEABOARD AIR LINE RAILWAY COMPANY UNDERLYING BONDHOLDERS' PROTECTIVE COMMITTEE

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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VENABLE, BAETJER AND HOWARD,
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ADDENDA

We have been advised since this brief was printed that the Circuit Court of Appeals for the Fifth Circuit has also overruled Petitioners' objections to the Seaboard Plan of Reorganization, and has approved the Plan.

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Supreme Court of the United States

OCTOBER TERM, 1944

No. ——

F. G. BADENHAUSEN, WILLIAM S. SPATCHER AND HOWARD H. HUBBARD, CONSTITUTING THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF GEORGIA & ALABAMA RAILWAY FIRST MORTGAGE CONSOLIDATED 5% GOLD BONDS, DUE 1945, AND LESTER MARTIN,

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals for the Fourth Circuit is printed at R. 119-125.

The United States District Court for the Eastern District

of Virginia (Chesnut, D.J.) filed no opinion; its order dismissing the Petition is printed at R. 15-16.

There is a printing error in the District Court's order at R. 16: the last sentence of the third paragraph from the bottom of p. 16 should read—

> "The evidence submitted by the respondents supports *their answer* to the petition, the material averments of which I therefore find to be substantially correct. (Correction is italicized)

JURISDICTION

Petitioners invoke the jurisdiction of this Court under Section 240 (a) of the Judicial Code (28 U.S.C.A. Sec. 347), and Paragraph 5 (b) of Supreme Court Rule No. 38.

STATEMENT OF FACTS

We wish to correct and amplify the facts as stated by the Petitioners as follows:

These same Petitioners recently petitioned this Court for a writ of certiorari to review the approval of the Seaboard Air Line Railway Company Plan of Reorganization by the United States District Court for the Eastern District of Virginia (Chesnut, D.J.) and by the United States Circuit Court of Appeals for the Fourth Circuit. Certiorari was denied on January 8, 1945. *Badenhausen* v. *Guaranty Trust Company of New York*, 53 Fed. Supp. 672, *aff'd.*, 145 Fed. (2d) 40, *cert. den.*, 323 U.S. xx, 65 Sup. Ct. 440.

The Circuit Court there affirmed the District Court's specific finding in approving the Seaboard Plan of Reorganization (see 145 Fed. (2d) at 54)—

"that a larger allowance to the Georgia and Alabama could not be justified."

Petitioners cannot question this fact in this second proceeding.

This case involves no attempt to serve two masters without full disclosure to each master. From the beginning, all Underlying bondholders were put on notice that the Underlying Committee would represent all Underlying bonds (ten first lien divisional issues and one first lien on a leased line).

The Underlying Committee has always represented itself, not as a committee for any single Underlying issue, but as the "Underlying Bondholders' Committee." The letter soliciting deposits said (Underlying Exh. No. 2)—

> "It is considered imperative that the holders of the various issues of underlying bonds unite for concerted action to protect their interests. The undersigned Committee has been organized for this purpose***."

The possibility of a conflict of interest among the various issues was foreseen and provisions both permitting withdrawal and authorizing the Underlying Committee to require withdrawal were set forth in the Deposit Agreement (see Article Sixteen, pp. 39, 40; Article Six, p. 22). The right of withdrawal in all cases was of course conditioned upon payment of a pro rata share of expenses as limited by the terms of the Deposit Agreement.

As of November 1, 1943, the banks and trust companies of which members of the Underlying Committee were executive officers owned, either for their own account or in a fiduciary capacity, certificates of deposit for G&A bonds in an aggregate principal amount of $477,000.00; this figure is exclusive of the $500,000 G&A bonds of the Massachusetts Mutual Life Insurance Company which have been represented by the Underlying Committee throughout the receivership period—the president of that Company, the late Mr. W. H. Sargent, having been a member of the Underlying Committee until his death. (R. 13, 87).

From July 1931, at least until 1940 when the Special Master determined that the new capitalization would include no divisional mortgages but solely system liens, there was no conflict of interest of any kind existing between the various Underlying issues; up to that late date, there was only complete identity and unity of interests. (R. 23, 27).

That complete unity of interest rested chiefly on the following fact, as stated in the original solicitation of deposits (Underlying Exh. No. 2)—

> "The underlying bond issues of the Seaboard Air Line Railway Company cover separate sections of the road (in some cases separated sections), but together they constitute the first liens on over 2,000 miles out of approximately 2,200 miles of the main line of the system from Norfolk and Richmond to Tampa, and on the main East and West Lines from Hamlet to Atlanta and Birmingham, from Wilmington to Rutherfordton, from Savannah to Montgomery and Jacksonville to River Junction."

The advantages to Underlying issues of presenting a united front through the Underlying Committee will be further developed in the Argument.

The amount of withdrawal charges accrued per $1,000 G&A bond (excluding the 50c Federal Transfer Tax) is as follows:

Acrueed at 11/25/36	$15.00
Accrued at 2/6/40	$17.50
Accrued at 9/15/41	$18.00
Accrued at 7/2/42	$18.00
Accrued at 8/1/43	$18.25

(R. 113-6)

The reasonableness of these amounts has never been questioned, and is not an issue in the case.

When the problem of the allocation of new securities under a reorganization plan was presented, the Underlying Com-

mittee employed an experienced railroad engineer and expert (Mr. William Wyer) to prepare a formula which he thought was scientifically correct; in preparing his formula and using the year 1939 as a base for his studies and application, he was governed entirely by scientific theories applicable to all divisions and by the general railway and economic conditions; he did not prepare a formula or select the year 1939 for its application because of the merits or demerits or conditions of any particular Underlying Division (R. 76-79).

The Circuit Court said in its opinion on the Petitioners' first appeal (145 Fed. (2d) at 48, n.)—

> "The Underlying Committee's expert, William Wyer, also proposed a formula on a 'segregation' basis without regard to the interest of any particular underlying issue of bonds."

On or about July 6, 1942, the Underlying Committee filed in these proceedings a proposed Plan of Reorganization, and under date of July 6, 1942, mailed it to all depositors. Shortly thereafter, the newspapers and various financial services published summaries of the allocations proposed by this Plan (R. 114). *Apparently all G&A bonds or certificates of deposit owned by Appellants were acquired by them after the proposed Underlying Plan was fully publicized.* Certificates of Deposit were first registered in Mr. Lester Martin's name April 5, 1943 (R. 10). The first $5,000 of Mr. Badenhausen's $7,000 Certificates of Deposits were purchased by him December 29, 1942 (R. 70). The other members of the Badenhausen Committee do not own any of such bonds or certificates of deposit (R. 70). Mr. Mitnovetz, counsel for said Committee, purchased $5,000 bonds December 15, 1942, (when the bid side of the market was 16¼) and sold them some time in March 1943 (R. 70). The "asked" side of the market reached 34¾ during that month.

The Badenhausen Committee was organized about June 7,

1943, and its formation was suggested early in May, 1943, by Mr. Lester Martin and two other persons (R. 70-1).

If any of the Petitioners acquired any interest in G&A bonds prior to the proposed Underlying Plan and the publication thereof in July, 1942, they have made no claim on this record. In fact, although the charges they made by mail against the Underlying Committee were quite serious and highly abusive, none of them appeared personally in the District Court or offered any testimony whatsoever (R. 60-64, 115).

Petitioners' statement (Petition for Writ, p. 3) that the hearing below "was deferred by the District Court until April 20, 1944" seems hardly fair. The Court did not hear the matter immediately after November 5, 1943 when the answer was filed; but certainly Appellant's counsel indicated on November 30, 1943 that he did not want to take the matter up then (R. 81), and apparently asked for a hearing only shortly before the hearing on April 20, 1944. (R. 83).

SUMMARY OF ARGUMENT

The Underlying Committee's position on the questions sought to be raised by the Petition is:

1. This Court should not take jurisdiction. The decision below does not conflict with any decision of this Court. Also, the Courts below are Federal Courts, not State Courts.

2. There is no conflict of interest between the Underlying issues such as would require the Underlying Committee to cease representing G&A Bonds.

3. The case is moot.

4. Petitioners' position is not such as to move any equity court to grant them any relief.

ARGUMENT

I.

The Writ Should Be Denied On Jurisdictional Grounds

Petitioners urge this Court to grant the writ on one ground only: they claim that the decision below refusing to direct the Underlying Committee to cease to represent G&A Bonds, and refusing to direct that deposits thereof be withdrawn, presents a case for granting the writ under Paragraph 5 (a) of Supreme Court Rule No. 38. But both Courts below are Federal Courts, not State Courts; and their decisions in no way violate applicable decisions of this Court; as is shown under our next point in the argument (see p. 12 below).

II.

There Is No Conflict Of Interest Between Underlying Issues Such As Would Require The Underlying Committee To Cease Representing G&A Bonds

The contest here may be definitely narrowed:

1. There is no question here of an undisclosed or fraudulent joint representation. The record is clear that from the beginning every depositor with the Underlying Committee was on notice of the joint representation, and the reasons therefor. That is one major reason why cases like the *Woods* case are not in point.

2. If there is any rule against joint representation of conflicting interests in cases of full disclosure; then what is meant by "conflict of interest" within the meaning of the rule is the question here.

Where fraud is non-existent, the only purpose of such a rule would be to remove a hazard to a person's right to be represented to his best advantage. The purpose of any rule in such cases is certainly not to prevent a person from obtaining the representation most advantageous to him. Any pro-

hibited "conflict of interest" therefore does not include conflicts which are outweighed by a greater identity or unity of interest.

We submit that in the joint representation by the Underlying Committee of the various Underlying issues, as the actual unity and identity of interest has always exceeded and outweighed any possible conflicts of interest, there is no conflict of interest within the meaning of any joint representation rule.

The Petitioners say a forbidden conflict of interest exists chiefly because:

1. Many of the numerous theories urged or applied in arriving at the fair allocation under the Plan affected various Underlying issues differently.

2. The allotment of new securities to one old issue necessarily reduced the common fund of new securities remaining for allotment to other issues.

We agree these two situations existed in the Seaboard. We point out they have also existed in every corporate reorganization proceeding, railroad or otherwise. And we deny any conflict of interest justifying the relief prayed.

The advantages to all our Underlying issues of joint representation we think far outweighed any possible disadvantage from the considerations mentioned.

Each Underlying Divisional Mortgage is a First Lien, when considered alone, on a relatively small segment of the Seaboard system. But the ten Underlying Divisional Mortgages together constitute a first lien on almost the entire main line from Norfolk and Richmond to Tampa (in addition to east-west main lines)—the backbone of the Seaboard system (R. 89). If the right to take over a railroad by foreclosure be questioned or if various restrictions incident to the exercise of such right be suggested, no one will doubt the advantage arising from joint representation of such a collective first lien as compared

to separate and therefore unorganized representation of each first lien issue.

In contrasting joint representation to separate representation in this situation, the Underlying Committee's right to take over by foreclosure the backbone of the system to the exclusion of other security holders, or its right to use the surpluses on its strongest divisions for the benefit of the weaker or deficit divisions (such as Georgia and Alabama) is not so important; it is the threat that such a right might be exercisable or established by the Underlying Committee that gave to all Underlying issues—and especially the weaker or deficit lines such as Georgia and Alabama—much more advantageous representation than if ten separate committees were in the field.

Two illustrations of the major advantage to Georgia and Alabama of the joint representation given by the Underlying Committee will help to resolve the question of conflict:

1. In 1935, the issue of over $24,000,000 Receivers Certificates representing funds to maintain and operate the railroad and to retire equipment trust certificates threatened to undercut the first lien position of all Underlying issues. In view of the fact that Georgia and Alabama was a deficit line and therefore actually needed additional funds for its operation and maintenance, displacing the first lien thereon with Receivers Certificates might have been justified. But by using in its negotiations the prestige of the holder of the first lien on the whole, the Underlying Committee successfully maintained the first lien position of all Underlying issues.

2. When the reorganization stage was reached in 1939, the main fight arose (as in many other railroad reorganizations) between the Underlying issues as a group on the one hand, and the holders of junior securities as a group on the other. As shown by the figures on page 13, in the case of G&A, the Underlying Committee claimed over twice as much as the junior liens were willing to give them. We believe

that the representation by the Underlying Committee of a consolidated first lien presented the case for each Underlying issue in its strongest light both to the Special Master and the Courts as well as to our junior lien adversaries.

Jurisdiction.—If Paragraph 5 (a) of Supreme Court Rule 38 had made a conflict between the *Federal Court* decisions below and decisions of this Court, a ground for granting the writ, there would be no such conflict here.

The only case relied upon by the Petitioners bearing upon the question of conflict of interest is *Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262. Even in the absence of the other equities against Petitioners discussed under Points III-IV below, the *Woods* case is not applicable here:

(a) That was a case of secret and undisclosed joint representation. The bondholders committee there represented interests other than those (see pp. 268-9) "whom it (the claimant) purported to represent," and "for whom it (the claimant) purported to act." The facts there verged closely upon fraud.

(b) There were no advantages to the bondholders from the joint representation in the *Woods* case; it was entirely disadvantageous to their interests. The bondholders committee in its individual capacity was heavily interested in the equity securities; in fact, the committee as the representative of bondholders had a claim against itself individually.

That situation arose from the fact that two of the committee members were executive officers of the banking firm which had underwritten the bond issue and sold it to the public. The banking firm was heavily interested in the equity. Moreover, the committee had neglected its duty, representing bondholders, to enforce a claim against the banking firm for misrepresentation in the prospectus under which the bonds were sold.

We think that Petitioners' Petition and Brief shows the

aptness of Mr. Edwin G. Baetjer's characterization of Petitioners' idea of a conflict—

> "***I think the difficulty that you have is that a conflict is created when somebody claims something."
>
> (R. 29)

Mr. Baetjer pointed out that in a railroad reorganization, a creditor gets nowhere by merely presenting a claim for himself; he must support that claim by theories equally fair to other creditors—

> "***If you ever brought any formula and said: 'This is very satisfactory to the Georgia & Alabama', you would not be entitled to be heard unless you could say that it applied equally and was equally fair to all of the other issues."
>
> (R. 43)

The following figures give some idea of the fortunes of the G&A bonds in the reorganization process. Using for the purposes of a yardstick the following assumed values for new securities under the Plan: First Mortgage bonds, 100; Income bonds, 50; Preferred stock, 25; Common stock, 12½; the total allocation to each $1,000 G&A bond was—

Under the Consolidated 6s Committee Plan, filed about July 1, 1942	$117.00
Under the Underlying Committee Plan of about the same date	$279.00
Special Master's Plan of July 1943	$233.00
Special Master's Plan as modified and approved by the District Court on December 14, 1943	$294.00

(Plus a fixed percentage (Plan p. 16) of any cash that may be available for distribution from war earnings)

The following cases show that joint representation has become a common practice in railroad reorganization; and it

should be enjoined only where the facts clearly demand judicial intervention.

In the case of *Group of Investors* v. *Milwaukee R. Co.*, 318 U.S. 523, Mr. Justice Douglas had before him the reply Brief of the Group of Institutional Investors showing (page 5, note 1) that this Group represented six different bond issues; and also the Brief of Chicago, Terre Haute and Southeastern Railway Company and others showing on page 2 thereof (note 2) that the Terre Haute First Lien Bondholders' Committee represented "the First and Refunding Bonds, the Southern Indiana Bonds, and the Bedford Belt Bonds."

Petitioners could hardly have intended to claim that this Terre Haute Committee did not represent "public holders, as distinguished from private interests" (Petition, p. 10).

Incidentally Mr. Justice Douglas had about two years earlier delivered the opinion for the Court in the *Woods* case, upon which Petitioners rely.

See also Report in this case of Interstate Commerce Commission, dated February 12, 1940, Finance Docket 10882, 239 I.C.C. 485, where at page 513 it is said—

> "The Committee at the time of the February hearing consisted of 16 members representing insurance companies and banks, which as of December 31st, 1937 owned $75,310,000 of bonds of the Milwaukee and its affiliated companies, and $13,529,600 of the Milwaukee's equipment obligations, a total of $88,839,700 of securities. *The interest of the Committee is primarily with the Underlying Bonds* *** " (Italics ours).

The District Court's opinion, 36 F. Supp. 193, 196 (D. C. N. D. Ill. 1940), refers to the Committee as—

> "the holders of the securities of the debtor and other corporations involved in these proceedings, in an aggregate amount of $81,731,200."

In the *New Haven* Reorganization, the Report, dated August 27, 1941 of Interstate Commerce Commission, Finance

Docket No. 10992, 247 I.C.C. 677, said as to the Saving Bank Group (see p. 702)—

> "This group and its counsel, like the insurance group, by reason of its large and diversified holdings of obligations of the principal debtor and its subsidiaries took a prominent and active part in these proceedings from their commencement."

In the *Chicago and Northwestern* Reorganization, 35 F. Supp. 230 (D. C. N. D. Ill. 1940), *aff'd.*, 126 F. (2d) 351 (CCA 7th, 1942), *cert. den.*, 318 U.S. 793, the Brief of the Life Insurance Group Committee and Mutual Savings Bank Committee in the District Court showed that these two committees represented 52.5% of the General Mortgage Bonds as well as 31.4% of the divisional bonds consisting of eight separate issues; and also 9.3% of the 20-Year Convertibles and 30.6% of the Equipment Trust Certificates; this, as noted by the District Court, amounted in the aggregate to (see p. 236)—

> "$122,801,000 or 38.1% of $322,801,000 principal amount of certain issues of the debtor."

In the *Denver and Rio Grande* Reorganization, the intervening petition of the Insurance Group Committee filed with the Interstate Commerce Commission Finance Docket No. 11002, 233 I.C.C. 515, 540, shows that the Committee represented the following percentages of the following issues:

	More than
The Rio Grande Junction Railway Company First 5s of 1939	34%
The Rio Grande Western Railway Company First Trust 4s of 1939	30%
The Denver and Rio Grande Railroad Company Consolidated 4s of 1936	14%
The Denver and Rio Grande Railroad Company Consolidated 4½s of 1936	19%
The Rio Grande Western Railway Company Consolidated 4s of 1949	29%

Even if the Court determined the meaning of "conflict of interest" contrary to our contention, there would be no basis for disallowing to the Underlying Committee that part of the current withdrawal charge which accrued prior to any conflict of interest. As the table thereof in the Statement of Facts shows, that part of the withdrawal charge is substantially the whole.

III.

The Case Is Moot

The Petition in the District Court prayed for an order directing that deposits of G&A bonds with the Underlying Committee be withdrawn, and that such Committee cease to represent such bonds; no other relief was prayed.

The Plan of Reorganization of Seaboard Air Line Railway Company is now all but consummated. It is submitted that the question of representation of the G&A bonds has become immaterial and that this case is now moot.

Both the District Court and the Circuit Court have overruled the objections of these same Petitioners to the Seaboard Reorganization Plan, and have approved it; and this Court has denied certiorari. *Badenhausen* v. *Guaranty Trust Company of New York*, 53 Fed. Supp. 672, *aff'd.*, 145 Fed. (2d) 40, *cert. den.*, 323 U.S. xx, 65 Sup. Ct. 440.

Solicitation of assents to the Plan by the *Reorganization* Committee appointed by the District Court to administer and carry out the Plan has been so successful that on January 3, 1945 that Committee, pursuant to provision therefor made in the Plan, declared the Plan operative. As of March 31, 1945, 85 per cent of the G&A bonds had assented to the Plan and 82 per cent of all security holders to whom the Plan allots new securities had assented thereto.

Of the 85 per cent of G&A bonds which have consented to the Plan, approximately 55 per cent are deposited with the

Underlying Committee and approximately 30 per cent are free bonds deposited direct with the *Reorganization* Committee after its solicitation commenced in October, 1944 (the Underlying Committee has accepted no deposits since 1935). Of the 55 per cent deposited with the Underlying Committee, approximately 5 per cent are represented by certificates of deposit purchased by Petitioners. Petitioners and all other depositors were not only given 30 days published notice to withdraw their bonds after the Underlying Committee assented to the Plan on November 1, 1944, but for many years had had the right of withdrawal. The Deposit Agreement of course required payment of the withdrawal charge.

On April 10, 1945, the District Court had a hearing on the form of foreclosure decree and the "upset prices" to be fixed therein. It is contemplated that the foreclosure sale will be held on May 31, 1945.

The question of "upset price" is not in any way affected by whether or not the G&A bonds remain on deposit with the Underlying Committee. Petitioners were fully heard on that question at the April 10, 1945 hearing. As the Circuit Court put it (see R. 120)—

> "***It has not been shown that the retention by the Committee of the Georgia and Alabama bonds will prevent the determination of a fair upset price for the Georgia and Alabama Railway, especially as the relative values of the component parts of the Seaboard system have already been determined and the interested parties will have full opportunity to participate in the subsequent proceedings.***"

Manifestly at this late date, further committee representation of the G&A bonds has for all practical purposes become moot. The approved Plan and the progress made toward its consummation negatives the need for any real representation.

IV.

Petitioners' Position Has No Appeal For An Equity Court

With the question of representation a dead issue, the Petitioners nevertheless continue these proceedings.

We therefore think it is fair for us to suggest to the Court that the Petitioners' main purposes are not disclosed in their Petition. Motive, like conspiracy, is "hatched in a hollow tree," and ordinarily can only be shown by circumstantial evidence. Some of the following evidence is more than circumstantial; and where it is merely circumstantial, we submit it is compelling:

1. *Withdrawal Fees.*—Counsel for Petitioners admits one motive is to avoid the withdrawal fee provided in the Deposit Agreement (R. 115-6).

Even if the Court were to rule that ordinarily, because of a conflict of interest, the Underlying Committee should make no withdrawal charge, the Court should not so rule in the case of the Petitioners in this case; for the result would be the unjust enrichment of Petitioners contrary to all equity. As shown in the Statement of Facts, Petitioners recently purchased their Certificates of Deposit, necessarily at a price below the then current market price of "free" bonds; the approximate amount of such discount being the then current withdrawal charge of $18.00 per bond. (R. 111). They should not be permitted in effect to charge the prior owner with a withdrawal charge and pocket the money themselves.

For example, take Mr. Lester Martin: if he owns $321,000 face amount of certificates of deposit, disallowance of the Underlying Committee's withdrawal charge would unjustly enrich him by $5,858.25.

Mr. Edwin G. Baetjer had other equitable principles in mind when Petitioners cross-examined him on the question of the withdrawal charges—

"We expected to charge what the bondholders authorized us to charge for the services which we rendered, and we did not expect that any bondholder would wait and accept those services for eight years, and then, when the time came to pay, think it was an equitable rule to repudiate that obligation. And we know only one man who has done it."

* * * * *

"***He did not promise to pay his assessment if the reorganization turned out satisfactorily to him alone, and he never promised to pay the assessment on any conditions. Your client bought the bonds of a depositor who had actually agreed to all of these conditions, knowing every bit of it, and I cannot find any basis in what you call equitable principles for repudiating that obligation."

(R. 79-80)

2. *The Purpose of the Badenhausen Committee.*—The withdrawal fee could hardly be the main reason why Petitioners failed to exercise the right to withdraw the G&A bonds represented by the $321,000 certificates of deposit purchased by Mr. Martin.

A. Petitioners have never questioned the amount of the withdrawal charge.

B. Petitioners expect to obtain an upset price that will give them more dollars per bond than the new securities allocated to G&A will produce on the market.

The answer is clear. Petitioners want all G&A bonds represented by the Underlying Committee turned loose without a representative in the hope that the owners thereof having no other place to turn might deposit them with the Badenhausen Committee. And Petitioners realized that if they withdrew these deposited bonds their claim that the Underlying Committee should cease to represent those who want it to represent them would have a very shallow basis.

This motive is further revealed by the Interstate Commerce Commission's summary of the provision on expenses in the

original deposit agreement submitted by the Badenhausen Committee for the Commission's approval on June 21, 1943:

> "The 1½ per cent maximum includes 0.5 per cent to pay expenses of the 'Original Committee' (Underlying Bondholders' Committee) including counsel fees and expenses paid or incurred prior to June 19, 1943, and 1 per cent for the expenses incurred by the applicants on and after that date."
>
> (R. 73)

The Badenhausen Committee, having previously accused the Underlying Committee of gross misconduct and having threatened them vaguely with punishment, by this provision of the deposit agreement hoped to purchase from the Underlying Committee a recommendation that G&A bonds be deposited with the Badenhausen Committee. The Commission, of course, rejected this provision of the deposit agreement (R. 60-4, 73).

3. *Petitioners' Tactics.*—Upon the Petitioners' first appeal, the Circuit Court pointed out (145 Fed. (2) at p. 51)—

> "***Many of the Arguments urged in this court by these these appellants were presented to the District Court by the Underlying Committee. The Georgia and Alabama appellants made no appearance before the special master and appeared in the case for the first time at the hearings before the District Court in October, 1943. They presented no new evidence at these hearings."

Now on this second appeal, we find that Judge Chesnut spoke in a similar vein (R. 115)—

> "The Court: Don't you want to produce some testimony Mr. Mitnovetz?
>
> "Mr. Mitnovetz: No, Your Honor, I feel that the record is sufficient.
>
> "The Court: Let me say this: you have been down here time and again, and we are all happy to see you, especially when you can contribute anything helpful to the Seaboard reorganization; but we have never seen any of your clients. Now, on the kind of a question that you

are presenting to me, if presented in an equity court, I would certainly like to see Mr. Martin down here, and also Mr. Badenhausen, if you figure to persuade me to do something. They are complaining that the Underlying Bondholders Committee is not acting fairly for them. I feel that I would be helped by having them here in person. They are the parties in interest. You present no testimony whatever. Of course, I will be glad to study the case and carefully read the petition again and read the verdict.

"Now, I am going to say this. I don't care whether you produce somebody or not, but I do think when you are asking me to take an action like this, which would be somewhat drastic, that it would have been helpful to me to have seen the clients themselves and get their point of view."

It does not seem probable that these Petitioners who offered exactly *no* testimony on each of the matters appealed are too directly interested in the relief they said they wanted.

The impracticable suggestions and the threats and abuse used by Mr. Lester Martin in his exchange of letters with the Underlying Committee are sufficiently indicative of his motives as to require no comment (R. 60-4). The picture is further developed by the conduct of Petitioners' counsel in demanding from the Compromise Committee and from the Court a settlement on G&A bonds of 50 per cent of par value in market value of new securities, with no explanation of how he arrived at this figure (R. 82); and by his attempt to raise before the Interstate Commerce Commission the subject matter of this appeal, not just in the first instance upon his own application to form a G&A Committee, when it was perfectly clear the Interstate Commerce Commission had no jurisdiction (R. 67-8); but a second time in opposing the application of the Seaboard *Reorganization* Committee for Interstate Commerce Commission approval under Sec. 77 (p), when he even more obviously had no chance of success; and by his attempt to

incorporate into this record in the District Court the entire five volumes of testimony on reorganization (R. 84).

CONCLUSION

It is submitted that the petition for certiorari should be denied.

Respectfully submitted,

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